Tax Provisions

Jean Botomogno, Senior Economist
Ross Miller, Senior Economist
Ruhaiza Ridzwan, Economist
Phil Cummins, Economist
Glenn Wintrich, Economist

- Tax decreases: income tax rates reduced; corporate franchise tax and tangible personal property tax phased out
- Tax increases: new commercial activity tax; sales tax rate increased
- Distribution to local government funds frozen again

INTRODUCTION

Am. Sub. H.B. 66 (H.B. 66) makes many changes to Ohio's tax structure. Reductions include a phased-in 21% cut in the personal income tax, the phase-out of the corporate franchise tax for general businesses, and the phase-out of the tangible personal property tax for general businesses and telecommunications companies. Increases include the new commercial activity tax (CAT) and an increase in the sales tax rate from 5% to 5.5%. These changes are designed to improve the competitiveness of the Ohio economy by reducing disincentives for investment and employment. Once again, deposits into and distributions from the three local government funds were frozen at the levels of the most recent fiscal year.

Commercial Activity Tax

H.B. 66 creates a new privilege tax on business entities operating in Ohio, the commercial activity tax (CAT). The CAT, which is not a transactional tax, is the centerpiece of the tax reform package included in the budget bill. Generally, business entities with annual gross receipts below $150,000 are exempt from the CAT, those with annual gross receipts above $150,000 and less than $1 million will pay $150, and businesses with gross receipts above $1 million will pay $150 plus the CAT tax rate of 0.26% on gross receipts in excess of $1 million.

Any business activity conducted for or resulting in gain, income, or profit is taxable under the CAT. H.B. 66 expressly provides that the tax applies to all legal persons with substantial nexus with Ohio.[26] The CAT applies to in-state and out-of-state businesses with taxable Ohio receipts. For purposes of the CAT, an out-of-state business will have "nexus" with Ohio and be taxable if it has over $50,000 in real or personal property, $50,000 in payroll for work in Ohio, $500,000 in taxable gross receipts, or has 25% or more of its activity in the state.

All persons must register by November 15, 2005, or within 30 days of having receipts above $150,000 in a calendar year. The registration fee is $15 (if done electronically) or $20 per taxpayer. The cost of registration is applied against the taxpayer's CAT liability. Persons with receipts above $1 million

[26] As defined in section 5751.01 of the Revised Code, "person" means, but is not limited to, individuals, combinations of individuals of any form, receivers, assignees, trustees in bankruptcy, firms, companies, joint-stock companies, business trusts, estates, partnerships, limited liability partnerships, limited liability companies, associations, joint ventures, clubs, societies, for-profit corporations, S corporations, qualified subchapter S subsidiaries, qualified subchapter S trusts, trusts, entities that are disregarded for federal income tax purposes, and any other entities. "Person" does not include nonprofit organizations or the state, its agencies, its instrumentalities, and its political subdivisions.

are to pay quarterly. Returns are due by the 40th day after the end of a quarter, with the fourth quarter return being an annual reconciliation return. The first CAT returns are due February 10, 2006. For CY 2006, the subsequent due dates of tax returns will be May 10, August 10, and November 10. Persons with receipts below $1 million may elect to pay annually and file a single annual return by the 40th day after the end of the calendar year.

The CAT will be phased in over a five-year period from FY 2005 to FY 2010, with taxpayers paying an increasing share of their calculated CAT liability. For the biennium, CAT taxpayers will pay 23% and 40% of their CAT liability in FY 2006 and FY 2007, respectively. The percentage will increase to 60% in FY 2008 and 80% in FY 2009. The CAT will be fully phased-in in FY 2010 when taxpayers pay 100% of the tax liability. For the six-month period beginning July 1, 2005, and ending December 31, 2005, the tax for CY 2005 is $75 plus the product of 0.06% and receipts in excess of $500,000. Generally, the minimum tax is reduced to $75 if the taxpayer is first engaged in business in Ohio after May 1 and before December of a given year, and the first $500,000 is excluded from the tax.

Taxpayers

Unlike the corporate franchise tax, which applies only to corporations, the commercial activity tax applies to any legal person with more than $150,000 in annual taxable gross receipts in Ohio regardless of the person's legal or organizational form, unless the business entity is specifically excluded. H.B. 66 excludes public utilities, financial institutions, dealers in intangibles, insurance companies, and nonprofit institutions. These business entities will continue their current tax regimes. The budget act also exempts banks' holding companies, financial holding companies, certain financial services companies, and majority-owned affiliates of all those companies and those of financial institutions and insurance companies. All of these financial-type exempted companies would be subject to the corporation franchise tax if they were C corporations (or treated as corporations). The exemption is for financial-type companies engaged only in activities allowed for a financial holding company under federal law. However, if a nonfinancial company is a part of a merchant banking activity, the company may not be exempted from the CAT. For legal entities majority-owned by insurance companies, the bill requires that the insurance companies be authorized to do business in Ohio. H.B. 66 also excludes from the CAT persons formed by financial institutions solely for the purpose of facilitating or servicing securitizations transactions for financial-type institutions exempt from the CAT. The instrumentalities of the state (e.g., universities) are excluded from the CAT.

Taxable receipts

Taxable gross receipts (the tax base for the CAT) are amounts realized on sales by a person on transactions that contribute to the production of gross income, without deductions for the cost of goods sold or other expenses. The definition of "taxable gross receipts" includes numerous exemptions and exclusions. H.B. 66 excludes certain receipts such as interest (except interest on credit sales), dividends, and certain capital gains, even when received in the ordinary course of the taxpayer's business. Most business dividends and distributions are excluded from gross receipts, including an investor's pass-through income from an "S" corporation, partnership, limited liability company, or other type of pass-through entity. The following are also excluded from "gross receipts" for purposes of the CAT.

- Sales and use taxes collected by a vendor.

- Federal and state excise taxes paid on cigarettes and tobacco products, alcoholic beverages, and motor fuel.

- The portion of pari-mutuel horse racing wagers that legally must be held as purse money or collected as tax.

- Receipts from sales of lottery tickets in excess of agents' commissions, bonuses, and reimbursements.

- Certain receipts by a motor vehicle dealer for selling a motor vehicle to another dealer that intends to resell the motor vehicle. The exclusion from taxable receipts applies only to those transactions by new and used motor vehicle dealers that are needed to meet a specific customer's preference for a motor vehicle.

- Amounts or gross receipts from transactions between electric companies and regional transmission organizations regardless of whether they are received in the ordinary course of business or as a form of payment for an otherwise taxable transaction.

- Receipts from selling accounts receivables to the extent the receipts from the transactions giving rise to the receivables were previously included in the taxpayer's receipts.

- Hunting, fishing, and similar license fees collected by a person authorized to issue such licenses (the fees such persons may charge for issuing the license are not excluded).

- The portion of a real estate brokerage fee not retained by a broker (share paid to another broker or to a real estate salesperson). The exclusion applies only to the portion of the fee that applies in transactions in which the taxpayer is acting as a real estate broker.

- Receipts for services provided to a financial institution in connection with issuing, processing, servicing, and managing loans or credit accounts, if such financial institutions and the recipients of the receipts have at least 50% of their ownership interests owned and controlled by common owners.

- Gross receipts received from administering cancer treatment drugs in a physician's office to patients with cancer.

- Amounts derived from the sale of tangible personal property that is delivered into or shipped from certain foreign trade zones that include a transshipment station capable of receiving and shipping freight by rail, highway, and air transportation. This exclusion expires on June 30, 2007.

- Property, money, and other amounts received by a professional employer organization from a client employer in excess of the administrative fee charged by the organization.

- Receipts from the sale of motor fuel (excluded until June 30, 2007).

- Receipts of members of a consolidated group taxpayer, including sales to a member of the consolidated group for the use of the member in Ohio. Receipts are not excluded if they are received from sales to persons outside the group.

- Receipts of a combined utility company attributable to a heating company or a natural gas company. A combined utility company must pay the CAT with regard to taxable gross receipts from a public utility activity that is not subject to the public utility gross receipts tax.

Distribution of CAT revenues

In FY 2006, taxpayers will make two CAT payments (February and May) at the rate of 0.06% (23% x 0.26%) on taxable gross receipts. For FY 2007, the quarterly CAT payments will be made at the rate of 0.10% (40% x 0.26%) on taxable gross receipts. Revenues from the CAT will be deposited in the commercial activity tax receipts fund in the State Treasury. The Department of Taxation estimates that the CAT will generate approximately $219.0 million in FY 2006 and $449.0 million in FY 2007, or $668.0 million for the biennium. This estimate is subject to a large degree of uncertainty because the CAT is a new tax without history in Ohio or nationwide. Most likely, the degree of compliance with the new tax will determine the level of CAT revenues in the biennium. H.B. 66 earmarks revenues from the CAT for the GRF and for reimbursing school districts and other local governments for the reductions and phase-out of local taxes on most tangible personal property. To that end, revenues from the CAT will be distributed to the School District Tangible Property Tax Replacement Fund (SDRF) and to the Local Government Tangible Property Tax Replacement Fund (LGRF).

Varying percentages are applied to the distribution of revenues from the commercial activity tax. For FY 2006, the GRF will receive 67.7% of CAT revenues, the SDRF will receive 22.6%, and the LGRF will receive 9.7%. Based on the revenue estimates above, the GRF will potentially receive $148.3 million, the SDRF $49.5 million, and the LGRF $21.2 million.

For FY 2007, the GRF will not receive distributions from the CAT (distributions to the GRF are to resume in FY 2012). The SDRF and the LGRF will receive 70.0% and 30.0% of CAT revenues. Revenues to SDRF and LGRF are estimated at $314.3 million and $134.7 million, respectively, for a total of $449.0 million in FY 2007. Thus, for the biennium, the CAT would provide $148.3 million to the GRF, $363.8 million to the SDRF, and $155.9 million to the LGRF. Total revenues from the CAT for replacing revenues from the tangible personal property (TPP) tax may be $519.7 million for the biennium.

LSC estimates that $493.0 million will be required in FY 2007 for the SDRF and the LGRF during the phase-out of the TPP tax. The Department of Taxation estimate of the same replacement amount is $527.3 million. Revenues from the CAT in FY 2007 ($449.0 million) might be inadequate to fully reimburse school districts and local governments for the loss of revenues from the tangible personal property tax in FY 2007. This may require a transfer from GRF to the LGRF and SDRF of between $44.0 million and $78.3 million.

Rate adjustments

H.B. 66 prescribes a rate adjustment mechanism if revenues exceed or fall below certain thresholds during three specified "test" periods. For the period of July 1, 2005 through June 30, 2007, expected revenues from the CAT are $815 million. For the period of July 1, 2008 through June 30, 2009, expected revenues from the CAT are $1.190 billion. For the period of July 1, 2010 through June 30, 2011, expected revenues from the CAT are $1.610 billion.

If receipts from the CAT exceed the expected revenues for the defined periods by more than 10%, the rate is adjusted downward to the rate that would have produced the specified revenues over the test period minus one-half of the amount by which actual revenue exceeded 110% of the expected amount. Also, 50% of the excess revenue (above 110% of the expected amount) is credited to the Budget

Stabilization Fund (BSF) and the other 50% is credited to the newly created CAT Refund Fund. Moneys credited to the CAT Refund Fund are returned to the CAT taxpayers that fully paid their taxes for the year in which the test period ends. Each taxpayer is entitled to its pro rata share of the excess revenue credited to the CAT Refund Fund based on the taxpayer's CAT liability as compared to the total liability of all taxpayers. If receipts fall short of 90% of expected revenues for any of the three test periods, the rate is adjusted upward to the rate that would have produced the expected amount over the test period. The Tax Commissioner will compute the new CAT rate.

Situsing of receipts

Only gross receipts sitused to Ohio are taxable under the commercial activity tax. H.B. 66 prescribes specific situsing rules for the various kinds of gross receipts. The following receipts are sitused to Ohio:

- Gross rents and royalties from real property located in Ohio.
- Gross rents and royalties from tangible personal property to the extent the property is located or used in Ohio.
- Gross receipts from the sale of real property located in Ohio.
- Gross receipts from the sale of tangible personal property if the purchaser receives the property in Ohio. Property received in the state for transportation by the purchaser to a location outside Ohio is not to be sitused in Ohio, but rather to the place where the property is ultimately located. Tangible personal property delivered into a foreign trade zone located in Ohio for the purpose of delivery out of Ohio, without regards to the passage of title and repackaging for further shipping purposes, shall be sitused to the location at which the person or person's affiliated customer delivers the property outside Ohio. H.B. 66 excludes from taxable gross receipts amounts derived from the sale of tangible property that is delivered into or shipped from "qualified" foreign trade zones that have a transshipment station capable of receiving and shipping freight by rail, highway, and air transportation ("intermodal" FTZ). This exception is temporary and expires on June 30, 2007.
- Gross receipts from trademarks, trade names, patents, copyrights, and similar intellectual property to the extent the property is used in Ohio.
- Gross receipts from the sale of services, and all other gross receipts not otherwise mentioned above are sitused to Ohio proportionately to the purchaser's benefit in Ohio. The physical location where the purchaser receives and uses the benefit would determine the share of benefits received in Ohio.
- Gross receipts from the sale of transportation services by a common or contract carrier will be sitused in Ohio based on the mileage in the state as compared to everywhere else.

Tax Credits

A limited number of tax credits, none of which will reduce revenues in the FY 2006-2007 biennium, may be applied against the CAT. A taxpayer may apply job creation and retention tax credits and two qualified research expenses credits against the CAT. These credits are currently available for the corporate franchise tax and the personal income tax.

The job creation tax credit is a refundable[27] credit available to a CAT taxpayer for new jobs created pursuant to an agreement with the Ohio Tax Credit Authority. The credit is equal to a designated percentage of the total amount of Ohio income tax withheld from new employees during the calendar year. The percentage is established in the agreement between the taxpayer and the Tax Credit Authority. The credit may be granted for a period of up to ten years.

The job retention tax credit is a nonrefundable[28] credit. Employers making at least $200 million in capital investments at a project site over a three-year period and with at least 1,000 full-time employees at the site may reach a retained jobs tax credit agreement with the Ohio Tax Credit Authority. In certain conditions, the taxpayer is required to make $100 million in investment over three consecutive years if the average wage is 400% above the federal minimum wage. The credit is equal to a designated percentage (not to exceed 75%) of the total amount of Ohio income tax withheld from employees at the project site during the calendar year (the percentage is established in the agreement between the taxpayer and the Tax Credit Authority). The credit may be granted for a period of up to ten years. Any unused portion of the credit may be claimed in a future tax year, but may not be carried forward beyond three tax years.

The nonrefundable tax credit for qualified research expenses is equal to 7% of the excess of qualified research expenses over the taxpayer's average annual qualified research expenses incurred in the three preceding calendar years. This credit may be carried forward for seven calendar years.

The nonrefundable credit for qualified research and development loan payments is equal to a borrower's qualified research and development loan payments made during the calendar year preceding the tax period for which the taxpayer is claiming the credit. The amount of the credit for a calendar year shall not exceed $150,000 and the taxpayer must obtain a certificate issued by the Director of Development. The credit may be carried forward to the next tax period or periods. The aggregate credit for loan payments against the personal income tax, the corporate franchise tax, and the commercial activity tax cannot exceed $150,000 per taxpayer per year.

The tax credits will not be allowed against the commercial activity tax if they were available against the corporate franchise tax or the personal income tax, except to the extent the credits were not applied against those taxes. The tax credits against the CAT must be taken in the following order: (1) the nonrefundable jobs retention tax credit, (2) the nonrefundable credit for qualified research expenses, (3) the nonrefundable credit for a borrower's qualified research and development loan payments, and (4) the refundable jobs creation tax credit. The credits can be applied against the CAT beginning on or after July 1, 2008, and can no longer be applied against the corporation franchise tax or the personal income tax after that date.

H.B. 66 creates a CAT tax credit if CAT revenues exceed specified thresholds. A portion of the excess revenues credited to the CAT Refund Fund will be returned to CAT taxpayers based on their pro rata share of liability compared to the total liability of all taxpayers entitled to the credit. The tax credit is allowed for CY 2008, CY 2010, and CY 2012 if a transfer was made from the GRF to the CAT Refund Fund in the preceding calendar year.

---

[27] If the value of the credit is greater than the amount of tax owed, then the tax liability is reduced to zero and the taxpayer gets a refund equal to the amount by which the value of the credit exceeds the amount of tax owed.

[28] If the value of the credit is greater than the amount of tax owed, then the tax liability is reduced to zero and the taxpayer does not receive a refund. For some credits, the excess credit may be carried forward and applied to another year or years.

Corporations (subject to the corporation franchise tax) with a net operation loss (NOL) deduction of more than $50 million will be able to claim a NOL tax credit against the CAT beginning in tax year 2010. The credit will be phased in over ten years, but may not exceed 50% of the taxpayer's CAT liability in any year (after deducting any other credits). The Tax Commissioner may audit the accuracy of the value of the net operation losses or other lost unrealized tax assets (due to the phase-out of the corporate franchise tax).

Miscellaneous

H.B. 66 prohibits a taxpayer from billing or invoicing the CAT to another person. However, a taxpayer is not prohibited from adding the tax to the price of a good or service, and the tax remains part of the price for purposes of the sales and use tax. Business privileges may be revoked for noncompliance with the CAT law, and a person may not reregister until all outstanding taxes, penalties, and interest are paid in full. The budget act also provides for the refund of CAT tax liability and specifies the conditions under which an outstanding debt owed by a CAT taxpayer becomes final and offsets a refund of CAT liability. Sampling of taxpayer receipts during audits is allowed. The sampling method will be adopted by administrative rule, and the Tax Commissioner is required to try in good faith to reach agreement on the sampling method with the taxpayer.

Taxable gross receipts are to be calculated on an accrual basis,[29] rather than a cash basis, unless the taxpayer is not required to use accrual basis accounting for federal income tax purposes. The taxpayer must use the same accounting method for the CAT as it uses for federal income tax purposes for the same period of time. Taxpayers must include in their taxable gross receipts the value of property received outside Ohio and transferred into Ohio within one year after its receipt, unless the Tax Commissioner ascertains that the transfer was not carried out for purposes of avoiding the CAT.

Personal Income Tax

H.B. 66 made several changes to the personal income tax. The most notable is the 21% reduction in the personal income tax rates over a five-year period. The other major reduction to the personal income tax is a tax credit for low-income taxpayers. Increases to the personal income tax include: delaying the inflation adjustments to the personal income tax brackets until taxable year 2010, making the trust tax permanent, and eliminating the deduction for qualified tuition expenses.

Personal Income Tax Rate Adjustments

This provision reduces the marginal tax rates for each income bracket by a total of 21% over five years, beginning with taxable year 2005, in nearly even per-year increments. For each taxable year beginning after 2009, the income tax rates will be the same as for taxable year 2009. The rate reductions are estimated to reduce revenues from the personal income tax by $316 million in FY 2006 and $660 million in FY 2007.

Tax Credit for Low-Income Taxpayers

The personal income tax credit for low-income taxpayers essentially exempts from the personal income tax those taxpayers whose Ohio taxable income (Ohio adjusted gross income less personal

---

[29] In accrual accounting, transactions are counted when the order is made, the item delivered, or the service occurs, regardless of when the money for them is actually received or paid.

exemptions) does not exceed $10,000. This provision will reduce personal income tax revenue by an estimated $14.1 million in FY 2006 and $13.2 million in FY 2007.

Inflation Adjustments to the Personal Income Tax Deferred

Prior to H.B. 66, the personal income tax brackets were to be adjusted for inflation annually by the Tax Commissioner beginning in taxable year 2005. H.B. 66 defers that adjustment until taxable year 2010, after the phase-in of the rate reduction is complete. This provision increases revenue from the personal income tax by an estimated $65 million in FY 2006 and $126 million in FY 2007.

Permanently Extending the Trust Tax

The tax on trusts was set to expire at the end of taxable year 2004. The tax was only in effect for taxable years 2002, 2003, and 2004. H.B. 66 extends the trust tax past taxable year 2004. This will increase revenue from the personal income tax by an estimated $19 million in FY 2006 and $55 million for each year thereafter.

Elimination of the Deduction for Qualified Tuition and Fees

Prior to H.B. 66, taxpayers were permitted to take a deduction for certain tuition expenses and fees paid during the taxable year. The deduction was available for tuition and fees paid to a state university or other postsecondary institution located in Ohio. H.B. 66 eliminated the deduction. The elimination of this deduction will increase revenues from the personal income tax by an estimated $13.4 million per fiscal year, beginning in FY 2007.

Sales and Use Tax

H.B. 66 makes several changes to the sales and use tax law. The changes include an increase in the tax rate and the vendor discount, the repeal of the exemption for sales of investment coins and bullion, and an update of the law to conform to the Streamlined Sales and Use Tax Agreement.

Increase in the sales and use tax rate

H.B. 66 raises the statutory sales and use tax rate to 5.5%, up from 5.0%. The sales and use tax rate was temporarily set at 6.0% for FY 2004 and FY 2005 by the budget bill for the FY 2004-2005 biennium, Am. Sub. H.B. 95 of the 125th General Assembly, and was to return to the previous rate of 5.0% on July 1, 2005. This increase in the sales and use tax rate will enhance GRF revenues by up to $715.7 million in FY 2006 and $739.3 million in FY 2007.

Increase to the vendor discount

The budget act maintains the vendor discount for prompt remittance of sales and use tax collections at 0.9%. Am. Sub. H.B. 95 of the 125th General Assembly temporarily set the vendor discount at 0.9% between July 1, 2003 and June 30, 2005. The vendor discount was to return to 0.75% on July 1, 2005. The increase in the vendor discount potentially decreases GRF receipts by up to $16.4 million in FY 2006 and $17.2 million in FY 2007.

Repeal of the exemption for sales of investment coins and bullion

H.B. 66 repeals the sales tax exemption for sales of investment coins and bullion. The Department of Taxation estimates this provision will increase sales and use tax revenues by about $3.3 million in FY 2006 and $3.6 million in FY 2007.

Changes to conform to the Streamlined Sales and Use Tax Agreement

The budget act makes several changes to the sales and use tax law to comply with the Streamlined Sales and Use Tax Agreement (SSTA). H.B. 66 revises Ohio law regarding exemption certificates and changes the manner in which sales of digital goods and computer software or services are sourced when used in more than one taxing jurisdiction and the business consumer does not hold a direct payment permit.[30] The bill adopts the definitions in the SSTA for various types of communication services, and exempts sales by a vendor of a 900 service to a subscriber and sales of value-added nonvoice data services. The bill also amends the definition of "price" to address the treatment of coupons, discounts, third party payments, and other issues, and creates a new law regarding the tax treatment of "bundled transactions" by communication and other companies.[31] These changes to conform to the STTA potentially decrease GRF revenues.

County vendor license fee

Under current law, the Tax Commissioner may establish a registration system for payment of license fees available to remote vendors. The budget bill creates in the State Treasury the Vendor's License Application Fund in which vendor license fees collected by the Tax Commissioner are deposited. This change facilitates vendor registration and payment of fees, particularly for out-of-state vendors. The fees will be transmitted to the counties in which the vendor engages in business. The provision has no fiscal effect.

Corporate Franchise Tax

Phase-out of the corporate franchise tax

H.B. 66 phases out the corporate franchise tax (CFT) over a five-year period for nonfinancial corporations.[32] Financial corporations, which have a different tax base than general corporations, will

---

[30] Direct pay permit holders are consumers authorized by the Tax Commissioner to remit the tax directly to the state instead of the vendor. Direct pay permit holders include consumers whose number of purchase transactions of goods and services exceed 5,000 annually and whose Ohio state sales and use tax paid on these purchases exceeds $250,000 annually, or who purchase goods or services under circumstances normally making it impossible at the time of the purchase to determine if the goods or services are exempt from taxation.

[31] Companies may offer one bill for bundled transactions that may include various services such as telephone, cable, and high-speed Internet services.

[32] The corporation franchise tax has two alternative bases: *a net worth base and a net income base*. General corporations are required to compute their tax liability under each base and pay the higher of the two. Financial institutions are required to compute their tax based only on net worth and are taxed at 13 mills. The net worth tax rate for general corporations is 4 mills, and tax liability is capped at $150,000 per taxpayer. The net income tax rates are 5.1% and 8.5%. In addition, current law requires two supplemental "litter" taxes, which are capped at $5,000 each per taxpayer. The Tier I litter tax applies to all corporations except farms and financial institutions. Rates are 0.14 mills (net worth base) or 0.11% on the first $50,000 of taxable income and 0.22% for taxable income in excess of $50,000. The Tier II litter tax applies to taxpayers that manufacture or sell litter stream

continue to pay the 13 mills tax on their net worth base. Starting in FY 2006, nonfinancial corporations will pay a decreasing percentage of their regular CFT liability each year. For example, in FY 2006, CFT payments from nonfinancial corporations will be 80% of the overall tax liability. In FY 2007, CFT payments will be 60% of the calculated tax liability. In FY 2008 and FY 2009, nonfinancial corporations will pay 40% and 20% of their CFT liability, respectively. In FY 2010, only financial corporations will be paying the CFT, which will be eliminated for nonfinancial corporations. The phase-out of the corporation franchise tax will decrease CFT revenues by about $176.2 million in FY 2006 and $361.6 million in FY 2007. During the phase-out of the CFT, the withholding tax imposed on pass-through entities owned by corporations will be based on each corporation-owner franchise tax liability. The phase-out rate of the pass-through entity withholding tax applies only to corporation-owners that become subject to the newly created commercial activity tax (CAT). The bill specifies the way in which the various franchise tax credits that are carried forward will be claimed during the phase-out of the tax.

Limited Liability Companies

H.B. 66 clarifies how limited liability companies classified as corporations for federal purposes are treated under the corporate franchise tax law. Any association taxable as a corporation for federal income tax purposes will also be treated as a corporation for state franchise tax law, and an equity interest in the business shall be treated as capital stock. This change is expected to have a minimal fiscal effect.

Machinery and Equipment Tax Credits

H.B. 66 limits the availability of the corporate franchise and personal income machinery and equipment tax credits to new manufacturing machinery and equipment purchased by June 30, 2005 and installed by June 30, 2006. These tax credits were previously available for the purchase and installation of manufacturing machinery and equipment until December 31, 2015. The Department of Taxation estimates the elimination of the M&E tax credits potentially increases GRF revenues by $7.2 million in FY 2006 and $10.5 million in FY 2007.

Revenue from Litter Taxes transferred to the GRF

Under current law, all corporations (except family farm corporations and financial institutions) pay the Tier I litter tax. An additional Tier II litter tax applies to CFT taxpayers that manufacture or sell litter stream products in Ohio. Revenues from the litter taxes were distributed to the Recycling and Litter Prevention Fund. The budget act redirects revenues from the litter taxes to the GRF, and thus increases GRF revenues by $8.0 million and $7.2 million in FY 2006 and FY 2007, respectively.

Telephone company tax credit

H.B. 66 permits telephone companies a full recovery of the tax credit for expenses to aid the communicatively impaired in FY 2006. Telephone companies were exempted from the public utility excise tax and made subject to the CFT beginning in tax year 2005. For tax year 2005, telephone companies were required to compute taxes owed and net operating loss carry forward by multiplying the tax owed, net of nonrefundable credits, or the loss for the tax year, by 50%. This feature of law (Am. Sub. H.B. 95 of the 125th General Assembly) was to solve timing issues in moving businesses from one tax (public utility excise tax) to the other (CFT), but had the effect of limiting the credit amount that a

---

products (e.g., beverages, containers, etc.). Rates are 0.14 mills or 0.22% of Ohio taxable income in excess of $50,000.

company could claim. In FY 2006, telephone companies may claim the credit fully. This provision decreases GRF revenues by $3.1 million in FY 2006 only, according to the Department of Taxation.

Kilowatt-Hour Tax

H.B. 66 eliminated a provision of existing law that may change the allocation of revenues from the tax under specified conditions. While the largest portion of revenues from the tax (59.976%) goes to the GRF according to statutory formula, some of the revenue goes to the LGF (2.646%), the LGRAF (0.378%), the School District Property Tax Replacement Fund (SDPTRF, 25.4%), and the Local Government Property Tax Replacement Fund (LGPTRF, 11.6%). According to the provision eliminated, if revenue under the tax were below $552 million in a fiscal year, the allocation formula would be changed. In fiscal years before FY 2007, the GRF share would be reduced sufficiently to ensure that the LGF and the LGRAF would get the amounts they would have gotten under the statutory share if the total revenue had been $552 million. Similarly, beginning in FY 2007, the GRF share would have been reduced sufficiently to ensure that the LGF, the LGRAF, the SDPTRF, and the LGPTRF all received the amounts they would have received under the statutory formula if total revenue had been $552 million. The kilowatt-hour tax raised a total of $539.7 million in FY 2005, up slightly from $538.2 million in FY 2004. Allowing for growth in revenue at the rate projected in the May 2005 LSC revenue forecast, revenue would be approximately $551 million in FY 2006, triggering the change in allocation of revenues across funds, but is expected to exceed $552 million in subsequent fiscal years. Because the local government fund freeze provision in Section 557.12 of the bill would have overridden the statutory provisions in FY 2006, this provision of the bill would be expected to have no fiscal effect.

Domestic and Foreign Insurance Taxes

H.B. 66 extended the job creation tax credit, already existing for taxpayers of other business taxes, to domestic and foreign insurance companies. As with the existing credit, which is refundable, to claim the credit an insurer must submit a proposal for a project that would create new jobs in the state to the Tax Credit Authority. The authority must determine three things before entering into an agreement with the taxpayer for a credit: (1) that the project will create new jobs in Ohio, (2) that the project is economically sound, and (3) that receiving the credit would be a major factor in the taxpayer's decision to implement the project. The amount of the credit and the term of the credit are determined by the Tax Credit Authority subject to conditions specified in section 122.17 of the Revised Code. If the conditions are met, the Director of Development issues a tax credit certificate. The taxpayer must claim the credit for the calendar year specified in the certificate. The job creation tax credits are estimated to reduce revenues to the GRF from the domestic insurance tax and from the foreign insurance tax by approximately $2.6 million per fiscal year for each of the two taxes.

The bill also clarified language relating to the existing venture capital tax credit, as it applies to domestic and foreign insurers. The clarifications have no fiscal effect.

Dealers in Intangibles Tax

H.B. 66 provides for procedures whereby dealers in intangibles may petition for the review of penalties imposed upon them in connection with their reporting and payment of the tax. The budget bill also narrows the definition of who qualifies as a dealer in intangibles by specifying that the person must be engaged "primarily" in the specific activities that distinguish dealers in intangibles from other types of businesses, such as lending money, dealing in mortgages, other debt instruments, and securities for profit or gain, and requires the Tax Commissioner to adopt a rule clarifying the definition of "dealer in intangibles." These provisions have no fiscal effect.

Cigarette and Other Tobacco Products Tax

H.B. 66 increased the cigarette tax rate from $0.55 per pack of 20 cigarettes to $1.25 per pack of cigarettes on July 1, 2005. The tax on other tobacco products remains unchanged. The tax rate increase is expected to boost receipts from the tax on cigarette and other tobacco products by up to $457.0 million in FY 2006 and $443.0 million in FY 2007. The bill also imposes a "floor" tax on cigarettes in inventory on July 1, 2005. These cigarettes have the "old" stamp of $0.55 per pack of 20 cigarettes and dealers must pay the additional $0.70 on the amount of cigarettes in inventory. The "floor" tax, due on September 30, 2005, is expected to increase GRF revenues by about $64 million in FY 2006 only. H.B. 66 also allows an additional 5% discount to dealers for prompt remittance of the floor tax before or on August 15, 2005.[33] This additional discount is expected to decrease GRF receipts by about $3.6 million in FY 2006.

Under previous law, taxpayers could bring $60 worth of cigarettes for personal consumption into Ohio, without paying the cigarette excise tax or the cigarette use tax. H.B. 66 allows purchases of $300 worth of cigarettes each month without the payment of the use tax. This provision has the potential to substantially reduce tax revenues by encouraging more smokers to purchase cigarettes in lower taxing jurisdictions. The Department of Taxation estimates the potential revenue loss at $30.0 million in FY 2006 and $43.0 million in FY 2007. The potential revenue loss might be higher than this estimate, depending on the differential in rates between Ohio and other states, and potential changes in rates in other states.[34]

Taking into account the cigarette rate increase, the floor tax, and the change in use tax law, the net revenue gain from the cigarette and other tobacco products tax may be up to $487.4 million in FY 2006 and $400.0 million in FY 2007.

Revisions of laws governing the sale, distribution, and taxation of cigarettes

H.B. 66 revises numerous laws governing cigarette sales, distribution, taxation, stamps, records, reports of sales and purchases, seizure and forfeiture, inspection powers of the Tax Commissioner, licenses to manufacture and import, and electronic and mail order purchases. Most of these changes have no fiscal effect. The bill specifies that an importer for purposes of the cigarette excise tax is a person that imports finished cigarettes into the United States under a valid federal permit to engage in the importation of tobacco products. The bill changes references in the law regarding prohibitions against possessing unstamped cigarettes from a wholesale value of $60 to an amount of 1,200 cigarettes.

H.B. 66 creates a fine of up to $1,000 for transporting or causing cigarettes to be shipped to a person other than an authorized recipient of cigarettes (wholesaler or retailer). A person may not, without prior consent of the Tax Commissioner, transport cigarettes upon which taxes have not been paid if the quantity transported exceeds 1,200 cigarettes during any 12-month period. Manufacturers and importers are required to obtain licenses from the Tax Commissioner rather than county auditors. The identity of licensed cigarette distributors is subject to public disclosure. The bill makes other changes regarding the sale of cigarettes between manufacturers, wholesalers, and retailers. Except for the provision regarding

---

[33] Under existing law, cigarette excise taxpayers are eligible for a 1.8% discount when purchasing stamps as a commission for affixing stamps.

[34] As of July 1, 2005, Kentucky imposes a tax rate of $0.30 per pack of 20 cigarettes. West Virginia's rate is $0.55 per pack and Pennsylvania's rate is $1.35 per pack. The tax on a pack of 20 cigarettes is $0.555 per pack in Indiana and $2.00 per pack in Michigan.

the payment of the use tax on out-of-state cigarette purchases, these changes to the sale, distribution, and administration of the excise tax have no fiscal effect.

Estate Tax

H.B. 66 updates the state estate tax law to address changes in the federal estate tax law affecting the additional estate tax, the generation-skipping tax, and the deduction for family-owned business.[35] The changes are estimated to reduce the GRF share of estate revenue by $2 million in FY 2006 and $8 million in FY 2007.

The federal "Economic Growth and Tax Relief Reconciliation Act of 2001" phased out the federal credits for state estate or inheritance taxes and state generation-skipping transfer taxes. The credits no longer apply to estates of decedents dying December 31, 2004, or to generation-skipping transfers made after that date. H.B. 66 amends the sponge tax statutes to incorporate the changes made by the federal act and effectively repeals Ohio's sponge taxes.[36] The federal act also suspended the federal deduction for family-owned business interests. H.B. 66 repealed the state deduction for family-owned businesses to match the suspension of the federal deduction. Previously, the Ohio deduction could be claimed only if the federal deduction was claimed against federal estate tax liability.

Venture Capital Tax Credits for Dealers in Intangibles and Public Utilities

H.B. 66 extends the venture capital tax credits to dealers in intangibles and public utilities, and specifies how refundable and nonrefundable credits may be claimed for each tax-reporting period. Under previous law, the venture capital tax credits were available to businesses paying the corporate franchise tax, the personal income tax, or the insurance taxes. The venture capital tax credit is a refundable or nonrefundable credit for losses on loans made by businesses to the Ohio Venture Capital Program.[37] Venture capital tax credits are available only to "qualifying" dealers in intangibles, which are dealers affiliated with financial institutions. H.B. 66 also specifies that equity investors of a lender pass-through entity may claim their distributive shares of tax credits approved by the Ohio Venture Capital Authority, and requires the entity to elect refundable or nonrefundable credits. Although the Ohio Tax Credit

[35] The additional estate tax and the generation-skipping tax are based on federal credits and are sometimes referred to as "sponge" taxes because they allow the state to absorb as much revenue from an estate as is permitted by the federal credits. The sponge taxes allow a state to collect more revenue from an estate without increasing the estate's combined federal and state tax liabilities because the federal tax liability is decreased by the amount by which the state tax liability increases.

[36] The estate of a decedent who dies on or after January 1, 2002, but before the effective date of H.B. 66, receives a tax credit against the additional estate "sponge" tax. The credit equals the portion of the additional estate sponge tax that is over and above the sponge tax that would have been imposed if the tax had been equal to the maximum federal credit allowable for paying state estate taxes under the federal law that was in effect and applicable on the date of the decedent's death. This credit retroactively gives the relatively few larger estates that are subject to the sponge tax the tax reduction they would have received if Ohio's law had reflected the phase-out of the federal credit for state estate taxes.

[37] Am. Sub. S.B. 180 of the 124th General Assembly established the Ohio Venture Capital Program (effective April 9, 2003). Moneys in the Ohio Venture Capital Program are invested in venture capital funds, which in turn invest in Ohio-based businesses that are in seed or early stages of development or established Ohio-based businesses that are developing new methods or technologies. The program fund is funded through investments from private investors. Some of the profits from the program are put into the Ohio Venture Capital Fund (OVCF), which is used to secure the private investors against losses. To the extent the moneys in the OVCF are not adequate to secure an investor against losses, the investor is eligible for a tax credit granted by the Authority.

Authority may authorize these tax credits anytime, a taxpayer may not claim these credits during the first four years of the Ohio Venture Capital Program. The venture capital tax credits for dealers in intangibles and utilities will decrease GRF revenues in future years (outside this biennium).

Local Government Funds Freeze

The enacted budget "freezes" the amount of revenues to be credited to and distributed from the three local government funds – Local Government Fund (Fund 069), Local Government Revenue Assistance Fund (Fund 064), and Library and Local Government Support Fund (Fund 065) – in FY 2006 and FY 2007 to the lower of the FY 2005 "freeze" amounts or the amounts determined by the statutory formulas. Under the "freeze" tax receipts that would otherwise be credited to the local funds will instead be credited to the GRF. The freeze affects deposits and distributions of receipts from the "major" taxes: the personal income tax, the sales and use tax, the corporate franchise tax, the public utilities excise tax, and the kilowatt-hour tax.

Recent state operating budgets (H.B. 94 of the 124th General Assembly and H.B. 95 of the 125th General Assembly) included "temporary adjustments to local government distributions." After growing through FY 2001, distributions were frozen and reduced in FYs 2002 and 2003 and remained at the FY 2003 level for FYs 2004 and 2005. The FY 2005 amounts were equal to the FY 2003 amounts, which were equal to the FY 2001 amounts.[38]

Tangible Personal Property Tax

The budget bill phases out taxation of all tangible personal property of general business evenly over four years, eliminating this tax in 2009, except that new manufacturing equipment is exempted immediately. Virtually all receipts from taxation of tangible personal property go to local governments, other than a small amount paid to the Department of Taxation to defray administrative costs. In 2003, the latest year published, taxes currently levied on tangible personal property of general business totaled $1,637 million. The peak year for tangible personal property taxes levied was 2001, at $1,802 million.

Most of these forgone tax revenues will initially be reimbursed to local governments by the state, funded with receipts from the new commercial activity tax or, if these proved insufficient, from the General Revenue Fund. Reimbursement will be based on the value of tangible personal property in tax year 2004, and generally on tax rates in effect in 2004 or applicable to tax year 2005 or passed in elections prior to September 1, 2005, and applicable to tax year 2006. Two varieties of school district levies, which have phased-in or increasing rates, are to be reimbursed at their 2010 tax rates. For forecasting purposes, LSC assumes that the base amount for calculation of reimbursements will be similar to the amount of taxes levied in 2003. For tax levies designed to raise a fixed sum of money, such as

[38] H.B. 94 froze, for FY 2002 and FY 2003, deposits into and distributions from the Local Government Fund and the Local Government Revenue Assistance Fund at the levels of FY 2001. Deposits into and distributions from the Library and Local Government Support Fund were also frozen at the FY 2001 level, except that distributions to each county undivided library and local government support fund were further reduced by the county's pro rata share of any transfers made from the Library and Local Government Support Fund to the OPLIN (Ohio Public Library Information Network) Technology Fund.

H.B. 95 froze, for FY 2004 and FY 2005, deposits into and distributions from the three local government funds at the lower of the formula amount or the amount that those funds received in FY 2003. For the Library and Local Government Support Fund, the FY 2003 amount was the amount before the transfer to the OPLIN Technology Fund under Section 70 of H.B. 94 of the 124th General Assembly.

bond levies, reimbursement will be for amounts forgone in excess of 0.5 mill times the value of all taxable property (of all types, net of the tangible personal property that is no longer taxable) in each taxing jurisdiction. Fixed-sum levies will no longer be reimbursed after they cease to be in effect, with an exception through 2010 for emergency levies. Reimbursement from the state is estimated at $86 million in FY 2006 and $493 million in FY 2007. These reimbursement payments are to be phased out during 2011 through 2018.

Taxation of tangible personal property used by telephone, telegraph, and interexchange telecommunications companies is phased out over five years, eliminating the tax in tax year 2011. Both owned and leased property are no longer to be subject to this tax. State reimbursement to local governments for forgone tax revenues is similar to that for general business tangible personal property, phasing out in tax year 2019. Tangible personal property of other utilities and of persons other than utilities that lease such property to these utilities remains taxable.

The bill ends exemption from personal property taxation for patterns, jigs, dies, and drawings of electric utilities beginning in tax year 2006. Patterns, jigs, dies, and drawings of other utilities remain exempt. Assessment rates of electric companies are reduced beginning in that tax year, from 88% to 85% for transmission and distribution property and from 25% to 24% for all other taxable property. The lower assessment rates offset the tax increase that would otherwise result from eliminating the tax exemption for electric companies' engineering drawings, according to Department of Taxation calculations.

The bill exempts from the tangible personal property tax all oil and gas recovery equipment installed on the premises or leased premises of the owner. This exemption does not apply to public utilities. The value of the tangible personal property used in recovery of these minerals is to be excluded from the real property tax value of the minerals or mineral rights. The bill requires the Tax Commissioner to review multipliers used in oil and gas valuation in time for these provisions to be applicable to tax year 2006. These provisions may reduce tangible personal property tax receipts in tax years 2006 through 2008. However, the amount of oil and gas recovery equipment taxed as tangible personal property is unknown. The sections of the tax bill providing reimbursement to local governments for loss of tangible personal property tax receipts are specified in terms of a four-year phase-out schedule and would not provide reimbursement for any tax revenues lost as a result of full tax exemption in 2006 for the equipment covered by this provision. State education aid may increase in FY 2008 through FY 2010 as a result of this change.

A provision of the bill continuing a tax exemption for a performing arts center used by a charitable or educational institution, the state, or a political subdivision and conveyed to another, generally taxable entity if certain conditions are met may reduce personal property tax revenues to one or more local governments, and may increase state base cost funding for schools. This provision is discussed in more detail under "Real Property Tax."

The bill accelerates the phase-out of reimbursement to local governments for tax revenues forgone as a result of exemption from taxation of the first $10,000 of business tangible personal property. Under previous law, local governments were reimbursed in full by the state for this tax exemption. The FYs 2004-2005 budget bill, Am. Sub. H.B. 95 of the 125th General Assembly began a ten-year phase-out of this reimbursement, based on the amount reimbursed by the state in FY 2003. The current budget bill shortens the phase-out period to seven years, eliminating state reimbursement in FY 2010. Resulting savings to the GRF, relative to the ten-year phase-out schedule, are $5.7 million in FY 2006, $19.1 million in FY 2007, and continue through FY 2012. This phase-out schedule remains based on the amount of the FY 2003 reimbursement for the exemption, and is separate from both the four-year phase-out of the tangible personal property tax on general business described above and the reimbursement to local governments through 2018 for loss of that revenue source.

Real Property Tax

For real property used in a business activity, as defined in the bill, the 10% rollback of real property taxes is eliminated beginning in tax year 2005. Under previous law, all real property tax bills were reduced by credits equal to 10% of taxes charged. The state reimbursed local governments for the tax revenues forgone as a result of these credits. The new law raises real property taxes and eliminates state reimbursement, except for specifically listed types of property. Local government receipts are unaffected by this change, apart from timing differences resulting from a lag between tax payments and state reimbursement. Types of real property still eligible for the rollback include that used for farming; leasing property for farming; occupying, holding, or leasing property improved with one-, two-, or three-family dwellings; or holding vacant land that the county auditor determines will be used for these purposes.

Property still eligible for the rollback approximately coincides with Class I residential and agricultural real property, and that no longer eligible for the rollback with Class II all other real property. However, some Class I agricultural real property might be classified as used for an agricultural purpose other than farming, and therefore no longer eligible for the 10% rollback. Timberland is specifically excluded from the rollback benefit. The distinction between Class I and Class II real property is drawn for the purpose of determining tax reduction factors. The magnitude of the difference between Class II real property and the real property no longer eligible for the 10% rollback is unknown but is probably small relative to all property affected by this change.

The increase in real property taxes resulting from elimination of the 10% rollback, except for specifically listed types of property, is estimated to be approximately $300 million for tax year 2005 (generally payable in calendar year 2006). Savings to the state GRF will be about $150 million in FY 2006 and $300 million in FY 2007. These costs to business and savings to the state will grow over time.

The budget bill specifies that the real property tax exemption for buildings and lands of the 13 state universities, not used for profit, extends to those used for housing-related facilities, or for other purposes related to the university's educational purpose, and lands used for common space, walkways, and green space; that are under control of a charitable organization with which the university has a joint agreement entitling its students, faculty, or employees to use the lands or buildings; and for which the university has agreed to make payments to the organization sufficient to maintain required debt service coverage ratios on bonds related to the lands or buildings. Leasing of housing in such buildings shall not be considered a profit-making activity under this division. This clarification could result in loss of local government tax revenues due to the property tax exemption, and could increase state base cost funding for schools.

The bill specifies that a performing arts center used by a charitable or educational institution, the state, or a political subdivision continues to be exempt from taxation after its conveyance to an entity that is not a charitable or educational institution and is not the state or a political subdivision if certain quite specific conditions are satisfied. The property must have been tax-exempt for at least ten years, and must be leased to the entity that owned or occupied the property during those ten years. It must include improvements at least fifty years old, and be undergoing renovation in connection with a claim for historic preservation tax credits under federal law. It must continue to be used as a community or area center in which presentations in music, dramatics, the arts, and related fields are made in order to foster public interest and education therein. Finally, it must be certified by the United States Secretary of the Interior as a certified historic structure or as part of such a structure. This provision may reduce real property tax revenues, as well as personal property tax revenues, to one or more local governments, and may increase state base cost funding for schools.

The bill provides that real property of railroads not used in railroad operations is to be assessed by county auditors. The Tax Commissioner is to continue to assess real property used in railroad operations and tangible personal property of railroads. County auditors may incur additional costs to assess real property assessed under current law by the Tax Commissioner. The state's expenditures may decline as a result of this change.

The bill changes the process by which real property assessments are determined in reappraisal or update years by specifying that the Tax Commissioner, in deciding whether real property has been assessed at its correct taxable value, shall consider only aggregate values of property that existed in the prior year and is to be taxed in the current year. In addition to adjustments for new construction and property destroyed or demolished, any other adjustments that the Tax Commissioner considers necessary to comply with this requirement are to be made. Such adjustments could include reclassifications of properties, changes in tax-exempt status, and other changes. Under the procedure previously used, new construction was subtracted from the current year's value but other adjustments were not made in determining whether valuation was appropriate.

LSC estimates that changing the tax equalization procedure by subtracting destroyed property from the prior year's value would reduce taxable values statewide by roughly $150 million, or about 0.08% of total taxable property values. The net effect of making other adjustments could be positive or negative, but has tended to be negative, and would also likely be small relative to total statewide taxation. The reduction in taxes collectible that would otherwise result would be largely offset by smaller tax reduction factors. For inside millage, not subject to tax reduction factors, taxes due would decline an estimated $1.5 million as a result of subtracting destroyed property. Higher effective tax rates resulting from smaller tax reduction factors would raise additional tax revenues from new construction and other additions. On the other hand, lower taxable value would raise less tax revenue from new fixed-rate levies. State base cost funding payments to schools would rise as a result of lower real property valuations. Additional effort and expense may be required of the Department of Taxation's Tax Equalization Division to perform these more complex calculations. LSC does not have an estimate of the amount of any added expenditures required to implement this change.

Property Tax Administration Fund

The bill changes calculation of transfers to the Property Tax Administration Fund, used to defray Department of Taxation costs to administer property taxes. The current charge of 0.3% against the amount of the 10% real property tax rollback is raised to 0.33% for FY 2006 and to 0.35% for FY 2007 and thereafter. Current charges of 0.15% against public utility tangible personal property taxes and 0.75% against tangible personal property taxes are changed to 0.5% for FY 2006, to 0.56% for FY 2007, and to 0.6% for FY 2008 and thereafter. Charges in each fiscal year are based on the preceding tax year. For example, FY 2006 charges are based on tax year 2005. In conjunction with other changes described above – elimination of the 10% rollback on real property used in business activities and the phase-out of taxes on tangible personal property of general business – these changes result in transfers to the Property Tax Administration Fund that LSC estimates at about $14 million in FY 2006 and $13.8 million in FY 2007.

School District Income Tax

The bill permits school districts to apply school district income taxes only to earnings. With this change, school districts could either apply the tax to Ohio adjusted gross income less exemptions as at present or only to employee compensation and net earnings from self-employment that is included in Ohio adjusted gross income. The tax would be subject to approval by voters.

By applying the school district income tax to a narrower base, school districts might obtain voter approval of levies that would otherwise be defeated. Alternatively, the narrower base might result in reduction of school district revenues from income taxation. LSC has no estimate of the net revenue effect of this change.

Motor Fuel Tax and Motor Fuel Use Tax

H.B. 66 reduced the motor fuel tax discounts and shrinkage refunds provided to dealers for reporting and paying the motor fuel excise tax on time. Discounts and refunds were reduced for reporting periods between July 2005 and June 2007. This provision increases revenue to the Highway Operating Fund (Fund 002), the Waterways Safety Fund, and the Wildlife Boater-Angler Fund, and to municipalities, counties, and townships for FYs 2006 and 2007. The total amount of the revenue increase is approximately $6 million each fiscal year.

The enacted budget also gave school districts and educational service centers that failed to file an application for a refund of that portion of the motor fuel tax that became effective on July 1, 2003, 60 days after the effective date of the bill to file such an application. This provision has the potential to reduce revenue to the funds and local governments listed in the preceding paragraph by an unknown amount. The revenue loss will depend on the number of school districts and educational service centers that file such applications.

H.B. 66 also made changes to terms under which an individual must obtain a motor fuel use permit. It provides that an individual must obtain a permit only if operating a commercial car or commercial tractor on public highways in two or more states. It also eliminates a requirement that owners of farm trucks pay the tax annually and substitutes a requirement that they pay quarterly as do owners of other commercial cars and tractors. These provisions would have had a significant fiscal effect if the use tax still included a surcharge on the motor fuel tax, but this surcharge was eliminated, starting in FY 2006, by Am. Sub. H.B. 87 of the 125th General Assembly. Therefore these provisions have a minimal fiscal effect.

Natural Gas Consumption Tax

The bill eliminated a provision in existing law that relates to the amount of revenue collected under this tax. Revenues from this tax are split between the School District Property Tax Replacement Fund (SDPTRF, which receives 68.7% of the revenue) and the Local Government Property Tax Replacement Fund (LGPTRF, which receives 31.3%). Beginning in FY 2007, previous law provided that if revenue from the tax were less than $90 million, the difference between $90 million and the amount collected was to be transferred from the GRF to these two funds, with each fund receiving its statutorily proportionate share of the total difference. This provision was eliminated by the bill. The tax raised approximately $73.7 million in FY 2005, down slightly from approximately $76.4 million in FY 2004. This suggests that it is likely that the provision in previous law would have been triggered, and the transfers from the GRF to the SDPTRF and the LGPTRF would have been made. The precise transfer amounts would have depended upon natural gas usage, but historical experience suggests that this change would save the GRF approximately $15 million starting in FY 2007, and would reduce revenues to the SDPTRF by approximately $10.3 million and to the LGPTRF by approximately $4.7 million.

Tax Increment Financing

The budget bill makes various changes to the sections of the Revised Code dealing with tax increment financing districts. It removes the sunset provisions that previously applied to these districts. For a municipal corporation, county, or township with property in an incentive district – also known as an areawide tax increment financing district – that it did not create, the bill provides for notice regarding creation of the district and for compensation of up to 50% of the amount of taxes exempted in the eleventh or subsequent year of an exemption period that are in excess of a 75% tax exemption on the value of the improvement. The budget bill limits creation of an additional areawide tax increment financing district in a municipality, county, or township with a population of more than 25,000 if doing so would result in more than 25% of that local government entity's taxable value being located in incentive districts. Real property tax exemptions granted under tax increment financing law must begin in the tax year specified in the ordinance or resolution granting the exemption. Police or fire equipment is not a public infrastructure improvement that may be financed under tax increment financing law.

Transportation Improvement Districts

The budget bill authorizes a transportation improvement district and two or more government agencies to agree, before the end of 2005, on joint financing of a street, highway, interchange, or other transportation project. Any party to the agreement may issue securities, and the transportation improvement district may invest in these securities, representing the obligations of that party to the district for its share of the project's cost. More than half of the property needed for such a project must be located within the transportation improvement district.

Lodging Tax

The bill provides that a board of county commissioners of a county where a lodging tax is already in effect may adopt a resolution to levy an additional lodging tax up to 3% to make payments on bonds and notes issued by or for the benefit of a convention and visitors' bureau to construct and equip a convention center in the county. The bill also allows certain convention facilities authorities in Appalachian counties with populations less than 80,000 to levy a lodging tax at any rate up to 3%, and permits a board of county commissioners in a county with a population of 1,200,000 or more to establish and provide local funding options for constructing and equipping a convention center. A county with a population of 1,200,000 or more may levy a tax on lodging by transient guests at a hotel, to pay the cost of constructing, improving, expanding, equipping, financing, or operating a convention center. In addition, such a county may, for these purposes, levy a tax on food and beverages consumed on the premises where sold.

These provisions may increase local government revenues from taxes on lodging and on food and beverages, and may increase expenditures on convention centers in some counties. To the extent that potential hotel or motel guests respond to the higher tax by reducing their demand for lodging at Ohio facilities, tax revenues may not rise pro rata with the tax rate increase, and could even decrease.

Grain Handling Tax

The bill phases out the grain handling tax, reducing the tax rates in half in 2006, and eliminating the tax in 2007. Tax rates per bushel vary by type of grain. Revenues are distributed to local governments in proportion to their property tax rates. Grain handling tax receipts ranged from $229,403 to $287,800 in calendar years 1999-2002. The tax has been imposed in Ohio since 1935, but no adjacent state has a comparable tax.